Exhibit B

ORDER

November 20, 2007

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

Qwest Corporation, Plaintiff, vs. Arizona Corporation Commission; Jeff Hatch-Miller, Chairman, William A. Mundell, Commissioner, Mike Gleason, Commissioner, Kristin K. Mayes, Commissioner, and Barry Wong, Commissioner, in their official capacities as Commissioners of the Arizona Corporation Commission; and Level 3 Communications, LLC; and Pac-West Telecomm, Inc., Defendants.	No. CV-06-2130-PHX-SRB **ORDER**

Pending before the Court is Plaintiff, Qwest's challenge to the final orders of the Arizona Corporation Commission ("ACC") issued in two separate proceedings held to construe Qwest's obligations to Defendants Level 3 and Pac-West under amendments to their Interconnection Agreements.

I. BACKGROUND

A. Telecommunications Regulation

1. The Telecommunications Act of 1996

Prior to the enactment of the Telecommunications Act of 1996 ("TCA"), 47 U.S.C. 151 *et seq.*, local telephone service in this country "was provided primarily by a single company within each local area that had an exclusive franchise to serve an authorized territory within the state." *Verizon Cal., Inc. v. Peevey*, 462 F.3d 1142, 1147 (9th Cir. 2006). Congress's intent in enacting the TCA was "'to end the local telephone monopolies and create a national telecommunications policy that strongly favored competition in the local telephone markets.'" *Global NAPs, Inc. v. Verizon New England, Inc.*, 444 F.3d 59, 61-62 (1st Cir. 2006) ("*Global NAPs I*") (quoting *Global NAPs, Inc. v. Verizon New England, Inc.*, 396 F.3d 16, 18 (1st Cir. 2005)). In the wake of the TCA, a variety of telephone companies entered the local markets to take advantage of the new opportunities presented by deregulation. Level 3 and Pac-West are among these new market entrants, known as competitive local exchange carriers ("CLECs"), while Qwest, a carrier predating the TCA, is classified as an incumbent local exchange carrier ("ILEC"). *See Peevey*, 462 F.3d at 1146.

At the heart of the TCA is 47 U.S.C. § 251 which allows CLECs to interconnect with an ILEC's physical network. Section 251(a)(1) provides generally that "[e]ach telecommunications carrier has the duty - (1) to interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers." Under interconnection, the company serving the caller–known as the originating carrier–and the company serving the recipient–know as the terminating carrier–have "[t]he duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5). A reciprocal compensation arrangement is one where the LEC originating the call pays the LEC that terminates the call. *Peevey*, 462 F.3d at 1146. Thus, if a Qwest customer initiates a call to a Level 3 customer within the same local calling area, then Qwest must pay reciprocal compensation to Level 3.

ILECs' and CLECs' duties when negotiating the terms of an interconnection agreement are set forth in § 252. Carriers are obligated to negotiate in good faith, however, if they are unable to reach an agreement, then either "party to the negotiation may petition a State commission to arbitrate any open issues." 47 U.S.C. § 252(b)(1). The state

commission then must "resolve each issue set forth in the petition and response," and any resolution reached by the state commission must adhere to both the requirements of § 251 and any regulation promulgated pursuant to § 251. 47 U.S.C. § 252(b)(4)(C), (c)(1). If the parties are able to reach an agreement without resort to arbitration, then the agreement may be made "without regard to the standards set forth in subsections (b) and (c) of section 251." 47 U.S.C. § 252(a)(1).

Despite the TCA's overhaul of the regulatory landscape, the FCC has definitively stated that "the [TCA] preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic." *Peevey*, 462 F.3d at 1146 (quoting *In re Implementation of the Local Competition Provisions in the Telecomms. Act of 1996*, 11 F.C.C.R. 15499, 16013, ¶ 1034, 1996 WL 452885 (Aug. 8, 1996) ("*Local Competition Order*")). The first category, generally referred to as local calls, includes "traffic [that] stays within the boundaries of a local calling area." *Global NAPs I*, 444 F.3d at 62. The latter, which encompasses both interstate long distance and intrastate calls that cross the boundaries of a local calling area (commonly called exchange service or toll calls), is termed interexchange traffic. *Id.* at 62-63. The reciprocal compensation requirement created by § 251(b)(5) "applies only 'to traffic that originates and terminates within a local area.'" *Peevey*, 462 F.3d at 1146 (quoting *Local Competition Order*, 11 F.C.C.R. at 16013, ¶ 1033). Interexchange traffic, on the other hand, is subject to an intercarrier compensation scheme know as access charges. With access charges, the long distance companies receive payment from the caller and they then pay compensation to the originating LEC as well as the terminating LEC. Thus, if a caller with local service provided by Level 3, and long distance provided by AT&T, were to initiate a long distance call to an out of state friend with local phone service supplied by Qwest, then AT&T would collect a usage-based fee from the caller and would distribute a portion of that money to both Level 3 and Qwest.

2. Internet Service Provider ("ISP")-Bound Traffic

Generally, the reciprocal compensation system is an effective means for adequately compensating LECs for voice-based telecommunications. However, in the context of traffic delivered to ISPs, the system created by the TCA has presented entrepreneurial CLECs with an opportunity to engage in a sort of regulatory arbitrage–where the CLEC profits not by charging their customer, but instead by positioning itself to receive a disproportionate amount of reciprocal compensation. *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 F.C.C.R. 9151, 9153, ¶ 2, 2001 WL 455869 (Apr. 27, 2001) ("*ISP Remand Order*"). This situation arises because CLECs, not ILECs, typically serve ISP clients, and ISPs are in the unique position of receiving almost exclusively one-way traffic. *In re Core Commc'ns*, 455 F.3d 267, 270 (D.C. Cir. 2006). Unlike a normal voice customer, who would likely both place and receive local telephone calls, the ISPs typically only receive traffic; a customer (who generally obtains service from an ILEC) initiates the telephone call to the ISP (served by the CLEC), and that ISP then provides access to the world wide web through the local telephone connection. This is problematic because, under the reciprocal compensation system, the calling party's carrier pays the terminating carrier, thus providing economic incentives for companies to serve ISPs at rates well below market cost while deriving their revenues not from the ISPs, but from the ILECs instead.

Recognizing that "the existing intercarrier compensation mechanism for the delivery of [ISP] traffic . . . has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets," the FCC has repeatedly attempted to deal with the issue. *ISP Remand Order*, 16 F.C.C.R. at 9153, ¶ 2. In 1999 the FCC issued the *Declaratory Ruling, In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 14 F.C.C.R. 3689, 1999 WL 98037 (Feb. 26, 1999) ("*Declaratory Ruling*"), where it concluded that ISP-bound calls are "interstate traffic subject to the jurisdiction of the Commission under section 201 of the [TCA] and [are] not, therefore,

subject to the reciprocal compensation provisions of section 251(b)(5)." *ISP Remand Order*, 16 F.C.C.R. at 9152, ¶ 1. On appeal, the Court of Appeals for the District of Columbia Circuit vacated the *Declaratory Ruling*, and held "that the Commission had inadequately explained its conclusion that ISP-bound traffic is non-local." *In re Core Commc'ns*, 455 F.3d at 271. On remand, the FCC produced the *ISP Remand Order* wherein it again concluded that ISP-bound calls within a local calling area are not subject to reciprocal compensation, and did so in reliance on an alternative statutory provision, 47 U.S.C. § 251(g). *Id.* Section 251(g) exempts certain forms of telecommunications from the reciprocal compensation requirement of § 251(b)(5), including "exchange access, information access, and exchange services for such access to interexchange carriers and information service providers." 47 U.S.C. § 251(g). The FCC "found that calls made to ISPs located within the caller's local calling area fall within those enumerated categories-specifically, that they involve 'information access.'" *In re Core Commc'ns*, 455 F.3d at 271 (quoting *ISP Remand Order*, 16 F.C.C.R. at 9171, ¶ 42).

After concluding that local ISP-bound calls are not subject to reciprocal compensation under § 251(b)(5), the *ISP Remand Order* went on to create an interim regime where "reciprocal compensation rates for ISP-bound calls were capped, with the rate cap declining over time towards zero." *Peevey*, 462 F.3d at 1147. In conjunction with the filing of the *ISP Remand Order*, the FCC issued a notice of proposed rulemaking to decide whether to abolish the entire system of reciprocal compensation in favor of a bill-and-keep regime to create continuity and remove the vulnerabilities of the current system. *In re Core Commc'ns*, 455 F.3d at 272-3 (citing *Notice of Proposed Rulemaking, In the Matter of Developing a Unified Intercarrier Compensation Regime*, 16 F.C.C.R. 9610, 2001 WL 455872 (Apr. 27, 2001)). Thus, with the ultimate goal of moving towards a bill-and-keep regime, the *ISP Remand Order* created rate caps, market caps, the mirroring rule, and the new markets rule, all in an effort to slowly wean the CLECs off of reciprocal compensation for ISP-bound traffic. *Id.* at 273-74. For the purposes of this Order it is unnecessary to examine the details of the aforementioned provisions of the interim regime. However, the goal of the FCC actions in

the *Declaratory Ruling* and the subsequent *ISP Remand Order*, to "move aggressively to eliminate arbitrage opportunities presented by the existing recovery mechanism for ISP-bound traffic," is of paramount importance. *ISP Remand Order*, 16 F.C.C.R. at 9156, ¶ 7.[1, 2]

3. Virtual NXX ("VNXX") ISP-Bound Traffic

At the crux of the dispute in this case are Level 3 and Pac-West's use of VNXX technology for the transport of ISP-bound calls. The national system of telephone numbering is designed so that the first six digits of each ten digit telephone number correspond to the physical location of the customer to whom the number is assigned. *Peevey*, 462 F.3d at 1147-48; *see also Global NAPs I*, 444 F.3d at 63-64; *Global NAPs, Inc. v. Verizon New England, Inc.*, 454 F.3d 91, 96 (2d Cir. 2006) ("*Global NAPs II*"). The industry uses the following format: NPA-NXX-XXXX to route telephone calls and to determine how those calls should be billed to the customer and compensated from carrier to carrier. *Id.* As

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[1]In *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), the D.C. Circuit rejected the FCC's reasoning given in the *ISP Remand Order,* holding that it was error to exclude ISP-bound traffic from reciprocal compensation based upon the language of § 251(g). Despite finding that the FCC's logic was faulty, the D.C. Circuit left in place the interim rules created by the *ISP Remand Order*. *Id.* at 434. Rather than vacate the order, the court remanded the decision back to the FCC for further consideration based upon its belief that "there is plainly a non-trivial likelihood that the Commission has authority to elect such a system (perhaps under §§ 251(b)(5) and 252(d)(B)(i))." *Id.* Therefore, "the *ISP Remand Order* remains binding." *Peevey*, 462 F.3d at 1147 n.1.

[2]Following *WorldCom*, in July 2003 Core Communications petitioned the FCC to forbear from applying the four interim provisions set forth in the *ISP Remand Order*. *In re Core Commc'ns*, 455 F.3d at 274; *see Pet. of Core Commc'ns, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, 19 F.C.C.R. 20179, 2004 WL 2341235 (Oct. 18, 2004) ("*Core Forbearance Order*"). After considering the continuing necessity of the interim provisions, the FCC determined that the rate caps and the mirroring rule remained vital to furthering the objectives articulated in the *ISP Remand Order*. *In re Core Commc'ns*, 455 F.3d at 275. In contrast, the Commission concluded that the new markets rule and the growth caps had been obviated by recent trends in the ISP market, writing "'[m]arket developments since 2001 have eased the concerns about growth of dial-up ISP traffic.'" *Id.* (quoting *Core Forbearance Order*, 19 F.C.C.R. 20186, ¶ 20). On appeal, the D.C. Circuit upheld the Commission's decision. *See generally Id.*

intended, the first three digits, the numbering plan area (commonly called the area code), and the middle three digits, the exchange code, are assigned based upon physical location. *Id.* Under this system, when a customer assigned a particular NPA-NXX calls a second customer with a different NPA-NXX, the call will be compensated as an interexchange call subject to access charges if it migrates beyond the bounds of the local calling area. *Id.* Despite the geographical correlation of NPA-NXX codes to customers, technology permits carriers to assign virtual NPA-NXX codes–where the NPA-NXX bears no relation to the physical location of the customer. *Id.*

CLECs employ VNXX technology allowing them to provide local numbers to ISPs whose physical equipment resides in one centralized location. *Id.* Under this arrangement, ISPs avoid the inconvenience of having to locate their equipment in each distinct NPA-NXX area, ISPs' customers gain convenient access to the Internet without paying toll charges for the call, and it allows the CLECs to advance an argument–as they do here–that these calls are local calls because the NPA-NXX number initiating the call is assigned to the same local calling area as the NPA-NXX number receiving the call.

VNXX traffic is of special significance because it defies normal classification under either the access charge or reciprocal compensation regimes. *See Global NAPs II*, 454 F.3d at 100-01. Determining which area of intercarrier compensation VNXX calls fall under is of critical importance to the parties before this Court. If compensated pursuant to the access charge system used for calls placed outside the caller's local calling area, the originating LEC–generally an ILEC such as Qwest–will receive compensation for the phone call. However, if this traffic were subject to either the reciprocal compensation scheme or the capped scheme created by the *ISP Remand Order*, then Qwest would pay compensation to the terminating LEC–generally a CLEC such as Pac-West or Level 3.

Qwest's arguments in this case revolve solely around Pac-West and Level 3's use of VNXX, and can be summed up rather succinctly: Qwest believes that VNXX calls should be treated as long distance calls subject to the access charge regime. Qwest does not argue that VNXX technology is ineffective nor does it claim that allowing an ISP to locate its

equipment in one central facility is inefficient, it simply argues that the use of VNXX is designed to skirt the statutorily preserved access charge regime unfairly depriving Qwest of compensation for use of its infrastructure.

B. Arizona Corporation Commission Decisions

1. Pac-West v. Qwest, ACC Decision No. 68820

The proceedings before the ACC were initiated by Pac-West to redress what it believes to be Qwest's breach of the parties' interconnection agreement ("Pac-West ICA") and the ISP Amendment to the Pac-West ICA. (ACC R., *Pac-West Telecomm, Inc. v. Qwest Commc'ns*, Docket Nos. T-01051B-05-0495, T-03693A-05-0495 ("P-W R."), ACC Decision No. 68820 ("ACCD"), at 1.) The central question presented to the ACC was "whether VNXX ISP-bound traffic is eligible for reciprocal compensation under the [Pac-West] ICA, the ISP Amendment, and the *ISP Remand Order*." (P-W R., ACCD at 8, ¶ 20.)

The ACC began its decision by noting that "the precise classification of VNXX traffic remains unsettled" because "jurisprudence at the federal level is inconclusive, and state jurisprudence is conflicting." (P-W R., ACCD at 8, ¶ 20.) Relying primarily on language found in *Global NAPs I*, and emphasizing the unsettled nature of the law, the ACC concluded that the *ISP Remand Order* could be interpreted to include VNXX calls. (P-W R., ACCD at 9-10, ¶ 25.) After it reached the conclusion that the *ISP Remand Order* may be read to include VNXX traffic, the ACC turned to the issue of the Pac-West ICA and ISP Amendment. The ACC found pursuant to Sections 2 and 5 of the ISP Amendment that "[t]he plain language of the ISP Amendment provides for reciprocal compensation for all ISP-bound traffic." (P-W R., ACCD at 10, ¶ 26.) Without any indication that the ISP Amendment was intended to "exclude VNXX ISP-bound traffic, [the ACC] f[ound] that such traffic should be subject to reciprocal compensation under the terms of the ICA and ISP Amendment." (P-W R., ACCD at 10, ¶ 26.) As a result of the decision, the ACC determined that Qwest had "breached the terms of the ICA and ISP Amendment," and it ordered Qwest to pay reciprocal compensation to Pac-West as outlined in the decision. (P-W R., ACCD at 10-11, ¶¶ 28, 14.)

Sensing that the VNXX issue would continue to present difficulties and only create further disputes between telecommunications companies in Arizona, the ACC added the following observation as well as an order to the same effect:

> Because the issue of VNXX has now come before the Commission more than once, and we anticipate that it will continue to be an issue in the future, we will order Staff to open a generic docket to investigate and make recommendations in the form of a Staff Recommendation to the Commission regarding VNXX. Issues to be addressed by Staff should include what rates are applicable on an ongoing basis; whether VNXX results in misassigned local telephone numbers; and whether VNXX results in misused telephone numbering resources.

(P-W R., ACCD at 11, ¶¶ 29, 14.)

2. Level 3 v. Qwest, ACC Decision No. 68855

One month later, on July 28, 2006, the ACC issued a second order, this time to resolve a virtually identical complaint to the one addressed in the Pac-West matter. In the complaint filed with the ACC, Level 3 argued that Qwest had breached the Interconnection Agreement ("L 3 ICA"), and the accompanying ISP Amendment, by failing to pay the agreed upon rate of reciprocal compensation for ISP-bound VNXX traffic. (*See generally* ACC R., *Level 3 Commc'ns, LLC v. Qwest Commc'ns*, Docket Nos. T-01051B-05-0415, T-03654A-05-0415 ("L 3 R."), ACC Decision No. 68855 ("ACCD").)

Focusing on the plain language of the ISP Amendment, the ACC held that the agreement "does not carve out, or except, VNXX ISP-bound traffic." (L 3 R., ACCD at 13, ¶ 54.) The Commission then looked to the *ISP Remand Order*, which controls the definition of the term "ISP-bound traffic" as it is used in the ISP Amendment, and found that "the FCC's *ISP Remand Order* do[es] not limit the compensation scheme to only ISP-bound calls that originate and terminate in the same LCA." (L 3 R., ACCD at 13, ¶ 55.) The ACC further supported its decision by citing *Global NAPs I's* holding "that the *ISP Remand Order* does not preempt state authority to regulate intercarrier compensation for all ISP-bound traffic." (L 3 R., ACCD at 13, ¶ 57.) Finally, the Commission pointed to the FCC's own statement that the *ISP Remand Order* could be read to either support or oppose the argument

that VNXX traffic was addressed by the *ISP Remand Order*, and the FCC declined to opine which position was the better reading. (L 3 R., ACCD at 13, ¶ 55.) Thus, the ACC ordered Qwest to compensate Level 3 in a manner consistent with the order and further ordered Level 3 to discontinue use of VNXX technology per its resolution of an earlier case involving the parties. (L 3 R., ACCD at 14-15.)

C. Requested Relief

On September 6, 2006, Qwest filed this action seeking declaratory and injunctive relief from the orders of the ACC. Qwest has requested, among other relief, that the Court vacate the orders of the ACC issued in Decision Nos. 68820 and 68855; declare that the *ISP Remand Order* does not include VNXX ISP-bound traffic; and order Level 3 and Pac-West to refund monies that Qwest contends were paid in excess of its obligations under the agreements. After extensive briefing and consideration of the parties' oral arguments, the Court now turns to address the issues.

II. LEGAL STANDARDS AND ANALYSIS

A. Jurisdiction

The ACC has jurisdiction to arbitrate interconnection agreements under 47 U.S.C. § 252(b). *U.S. W. Commc'ns, Inc. v. Wash. Utils. & Transp. Comm'n*, 255 F.3d 990, 993 (9th Cir. 2001). Review by this Court is provided under 47 U.S.C. § 252(b) and 28 U.S.C. §§ 1331, 1337. *Id.*

B. Standard of Review

The district courts review *de novo* state agency interpretations and applications of federal telecommunications law. *See Peevey*, 462 F.3d at 1147 (citing *U.S. W. Commc'ns*, 255 F.3d at 994). "A state agency's interpretation of federal statutes is not entitled to the deference afforded a federal agency's interpretation of its own statutes under *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837, 843 (1984)." *Orthopaedic Hosp. v. Belshe*, 103 F.3d 1491, 1495 (1997). All other determinations, including those of contract interpretation, are reviewed under the arbitrary and capricious standard. *Peevey*, 462 F.3d at 1147. "A state commission's decision is arbitrary and capricious if the decision 'was

not supported by substantial evidence,' or the commission made a 'clear error of judgment.'" *Id.* (quoting *U.S. W. Commc'ns*, 255 F.3d at 994).

C. Qwest v. Level 3

The ISP Amendment to the L 3 ICA controls the relationship between the parties. Thus, before moving beyond the four corners of that document, it is necessary to determine whether the contract addresses VNXX ISP-bound traffic. The relevant language from the ISP Amendment reads: "The Parties agree to exchange all EAS/local (§ 251(b)(5)) and ISP-bound traffic (as that term is used in the FCC ISP Order) at the FCC ordered rate pursuant to the FCC ISP Order." (L 3 R., ACCD at 4, ¶ 22.) It is readily apparent that in order to give meaning to the term "ISP-bound traffic," as that phrase is used in the ISP Amendment, it is necessary to examine precisely how "that term is used in the FCC *ISP [Remand] Order*." (L 3 R., ACCD at 4, ¶ 22.) Only through a comprehensive review of the *ISP Remand Order* can the Court determine whether the FCC intended to include VNXX traffic within the compensation regime created by that order.

1. The *ISP Remand Order's* Applicability to ISP-Bound VNXX Traffic

Qwest argues that the ACC has misinterpreted the scope of the *ISP Remand Order* by applying it to VNXX traffic. Specifically, Qwest contends that the Commission failed to properly apply relevant case law and ignored key provisions of the *ISP Remand Order* which demonstrate that the FCC was attempting to deal solely with ISP-bound calls that originate and terminate within a single local calling area. In addition, Qwest argues that VNXX calls are not local and, therefore, are subject to access charges.

In opposition, Level 3 contends that the *ISP Remand Order* applies to all ISP-bound calls, regardless of whether they are VNXX. In support of this position, Level 3 points to the language used in the *ISP Remand Order* and the context in which it was decided. Level 3 also challenges as fundamentally flawed any characterization of VNXX traffic that would place it within the access charge regime. Finally, Level 3 claims that both public policy and recent court cases support its interpretation of the *ISP Remand Order*.

Conducting a review of the regulatory history, context, policy considerations and specific language used in the *ISP Remand Order* is critical to gain an understanding of its breadth. Because the *ISP Remand Order* makes no mention of VNXX, it is imperative that any reviewing court look to these crucial elements. The ACC's failure to conduct such an examination led to its conclusion that VNXX was within the definition of "ISP-bound traffic" as that term was used in the *ISP Remand Order*. Such an interpretation cannot be supported, and is therefore in violation of federal law.

a. Regulatory History and Context of the *ISP Remand Order*

The reciprocal compensation provisions of § 251(b)(5) apply solely to calls that originate and terminate in the same local calling area. *ISP Remand Order*, 16 F.C.C.R. at 9159, ¶13. In its *Declaratory Ruling* and the subsequent *ISP Remand Order*, the FCC's primary purpose was to consider whether ISP-bound calls *subject to reciprocal compensation under the current regime* had a basis in law to be excluded from the requirements of § 251(b)(5). The only ISP-bound calls that could possibly have been subject to reciprocal compensation were those originating and terminating within the same local calling area. Thus, the *ISP Remand Order* did not address ISP-bound calls subject to access charges. *See Global NAPs II*, 454 F.3d at 100 ("the FCC promulgated t[he *ISP Remand*] [*O*]*rder* specifically to address only the issue of reciprocal compensation for ISP-bound traffic.") An argument to the contrary would have to embrace the impossibility that the FCC was considering removing ISP-bound toll calls from the reciprocal compensation regime when those calls were not subject to reciprocal compensation in the first place.

This leaves the question of whether VNXX was ever subject to reciprocal compensation under § 251(b)(5) prior to the entry of the *ISP Remand Order*. The classification of VNXX traffic as either local, long distance, or some other non-traditional type of traffic is the responsibility of either the FCC or the ACC. In fact, the ACC has recognized this and has taken the initiative to establish a generic docket to address the issue. (*See* P-W R., ACCD at 11, ¶¶ 29, 14.) None of this, however, allows the Court to avoid the reality that VNXX has yet to be designated as a certain type of traffic, or dealt with in any

way by the organizations possessing expertise in the regulation of telecommunications. Without a finding that a VNXX call in Arizona is local–i.e., a call that actually originates and terminates within a local calling area–the Court cannot determine whether VNXX logically fits within the class of ISP-bound calls that spurred the FCC to take action to remove those calls from the purview of § 251(b)(5).

Within a few years of the 1996 enactment of the TCA, the FCC embarked on a course of action to remove ISP-bound traffic from the Act's reciprocal compensation regime–first in the *Declaratory Ruling* and later in the *ISP Remand Order*–because of its desire to eliminate the "enormous incentive for CLECs to target ISP customers." *ISP Remand Order*, 16 F.C.C.R. at 9183, ¶ 70. Due to the intercarrier compensation scheme created by § 251(b)(5), CLECs had an "incentive to target [ISPs] with little regard to the costs of serving them." *Id.* at 9183, ¶ 69. Based upon the findings of the FCC, this is exactly what CLECs did, and it resulted in a windfall for CLECs while damaging ILECs and their customers who do not use dial up Internet services. Evidence considered by the FCC in issuing the *ISP Remand Order* demonstrates that "CLECs, on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic." *Id.* at 9183, ¶ 70. This evidence led the FCC to conclude that "CLECs target ISPs in large part because of the availability of reciprocal compensation," not because of a legitimate free-market-based desire to serve ISPs. *Id.* As a result of this regulatory arbitrage, a CLEC can charge rates to its ISP customers "that bear little relationship to its actual costs, thereby gaining an advantage over its competitors." *Id.* at 9182, ¶ 68. This practice not only results in market distortions, it also harms the customers of LECs who are forced to bear the increased costs associated with the extreme imbalance in reciprocal payments to CLECs. *Id.* Consumers are not charged based upon the amount of reciprocal billing that is paid on their behalf, instead the costs of all local callers are averaged into the price charged to all customers of the LEC. *Id.* Thus, a customer who makes and receives only voice calls will

bear the increased costs incurred by the LEC's customers who direct much of their traffic to ISPs. *Id.*

While the *ISP Remand Order* can easily be faulted for failing to address VNXX traffic, it does not waver in its depiction of the factual context and the regulatory posturing that served as the catalyst for FCC action. In the *ISP Remand Order*, the FCC's motivation was to eliminate regulatory arbitrage and distorted markets that arose from the inclusion of ISP-bound traffic in the reciprocal compensation system applicable to calls originated and terminated by LECs *within the same local calling area.* The regulatory history does not support, as Level 3 contends, that the FCC was actually removing all ISP-bound calls, regardless of classification, from the reciprocal compensation versus access charge dichotomy and in place creating a separate class of traffic that would be controlled exclusively by the terms of the *ISP Remand Order.* At the base of Level 3's argument is the contention that "the FCC rejected the idea that the status of traffic as 'local' has any relevance to reciprocal compensation under Section 251(b)(5)." (Level 3 Commc'ns, LLC's Opening Brief ("L 3 Brief") at 21.) This argument, which is addressed in detail below, finds no support in the language or regulatory history of the *ISP Remand Order* and, for that reason, it fails.

b. Essential Language of the *ISP Remand Order*

The plain language of the *ISP Remand Order* reveals that the FCC's objective was to determine "whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP *in the same local calling area* that is served by a competing LEC." *ISP Remand Order*, 16 F.C.C.R. at 9159, ¶13 (emphasis added). VNXX ISP-bound traffic, by definition, involves an ISP located outside the caller's local calling area. Appearing in the "Background" section, this unambiguous statement is a description of the original question presented in the *Declaratory Ruling.* This statement has been attacked as being taken out of context, however, it is precisely the setting from which it was taken which gives it such force.

When the FCC answered the question presented in the *Declaratory Ruling* it was subsequently overturned on appeal and remanded to the Commission. On further consideration, the FCC issued the *ISP Remand Order* wherein it achieved the same result, albeit using a new analysis. Any argument challenging the continuing validity of the original question presented must presume that somehow the issue before the FCC was significantly broadened on appeal–from mere consideration of a single area of ISP-bound traffic to all ISP-bound calls, without so much as indicating once that it was doing so. If the Court were to adopt Level 3's position, then it would implicitly recognize that the FCC acted in violation of the principle "that an agency choosing to alter its regulatory course 'must supply a reasoned analysis indicating that its prior policies and standards are being deliberately changed, not casually ignored.'" *Action for Children's Television v. FCC*, 821 F.2d 741, 745 (D.C. Cir. 1987) (quoting *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir.1970)). The Court finds no evidence that the FCC contravened administrative law principles by silently expanding the scope of its action.

Unsurprisingly, the FCC's failure to clarify the scope of its action extends to its treatment of VNXX, a term that appears nowhere in the *ISP Remand Order*. To explain how the Commission addressed a form of telecommunications traffic without making mention of it, Level 3 posits that no such reference was required because the FCC was addressing the entire spectrum of ISP-bound calls, obviating the need for discussion of specific sub-classes, such as VNXX. Underlying this theory is Level 3's central argument: that the *ISP Remand Order* destroyed the distinction between "local" and "non-local" traffic, and instead created a separate regime under which all ISP-bound calls are subject to the compensation scheme created by the *ISP Remand Order*.

In the *ISP Remand Order* the FCC recognized that the "use of the phrase 'local traffic'" in the *Local Competition Order* and the *Declaratory Ruling* has "created unnecessary ambiguities," and, thus, it decided to discontinue use of those terms when distinguishing between types of traffic. *ISP Remand Order*, 16 F.C.C.R. at 9173, ¶ 46. Instead, the FCC concluded that calls are more properly classified either as calls subject to

§ 251(b) or calls excepted from that regime by § 251(g). *Id.* at 9172, ¶ 46. In rejecting the "local" versus "non-local" language, the FCC was simply implementing the D.C. Circuit's admonition that using such a distinction was an impermissible way to except certain ISP-bound traffic from the coverage of § 251. The FCC explained this failed logic as follows: "'[t]here is no dispute that the Commission has historically been justified in relying on this [end-to-end] method when determining whether a particular communication is jurisdictionally interstate,' [however,] the Commission had not adequately explained why the jurisdictional analysis was dispositive of, or indeed relevant to, the question whether a call to an ISP is subject to the reciprocal compensation requirements of section 251(b)(5)." *Id.* at 9160-61, ¶ 16.

Level 3 places great weight on the FCC's rejection of the "local" distinction, but this reliance is misplaced. In its argument, Level 3 writes, "[c]learly it makes no sense to interpret the *ISP Remand Order* as establishing a compensation regime limited to 'local' traffic (as somehow defined) when the FCC over and again repudiated any reliance on that terminology." (L 3 Brief at 24.) Although it may not make sense to distinguish "local" traffic, it makes perfect sense to separate § 251(b)(5) traffic from traffic falling under the § 251(g) exception. In one sense, Level 3 is correct–the *ISP Remand Order* did not "establish a compensation regime limited to 'local' traffic." (L 3 Brief at 24.) It did, however, establish a compensation regime limited to § 251(b)(5) traffic. This is fatal to Level 3's argument because neither the FCC nor the ACC have ever decided that VNXX traffic is subject to § 251(b)(5), and there remains the possibility that VNXX is instead subject to the access charges preserved by § 251(g), an area outside of the scope of the *ISP Remand Order*. *See Global NAPs II*, 454 F.3d at 101 (noting that "[V]NXX's potential compensation arrangement . . . [could] possibly involve toll and access charges[] [which] would differ from that contemplated in the 2001 *ISP Remand Order*").

c. Public Policy & the *ISP Remand Order*

An examination of the public policy concerns underlying the *ISP Remand Order* illuminates the FCC's intentions and further undermines Level 3's arguments. Both Level

3 and Qwest advance public policy arguments, however, Level 3's position distorts the facts and confounds common sense. Level 3 argues that the Commission's concerns were twofold, "dealing with marketplace distortions . . . and establishing a unified regime for intercarrier compensation." (L 3 Brief at 26 (citing *ISP Remand Order*, 16 F.C.C.R. at 9155-56, ¶ 7).) Surprisingly, paragraph 7 of the *ISP Remand Order* contains no mention of "establishing a unified regime for intercarrier compensation." It does, however, provide the following: "[i]n sum, our goal in this Order is decreased reliance by carriers upon carrier-to-carrier payments and an increased reliance upon recovery of costs from end-users." *ISP Remand Order*, 16 F.C.C.R. at 9155-56, ¶ 7. Creating a unified intercarrier compensation regime may be one of the overall goals of the Commission, but it is not the policy concern that motivated it to issue the *ISP Remand Order.*

From a policy perspective, Level 3's argument that all ISP-bound traffic should be compensated pursuant to the *ISP Remand Order* regime is simply untenable. If this interpretation were deemed credible, then the FCC would be placing *additional* traffic into a carrier-to-carrier payment scheme–the exact practice that the FCC was attempting to eliminate. A more logical conclusion is that the FCC intended to exclude both VNXX and ISP-bound traffic subject to access charges. For ISP-bound traffic subject to access charges, inclusion within the *ISP Remand Order* compensation system would only create additional opportunities for regulatory arbitrage, this certainly could not have been the Commission's intent.

d. Subsequent Statements by the FCC Concerning the *ISP Remand Order*

In *Global NAPs I*, the First Circuit invited the FCC to submit a brief as *amicus curiae* to address whether the *ISP Remand Order* preempts state regulation of VNXX ISP-bound calls. *Global NAPs I*, 444 F.3d at 74. The FCC's brief acknowledges the ambiguity inherent in the expansive language of the order and opines that, on its face, "the *ISP Remand Order* appears to address all calls." *Global NAPs I,* Brief for *Amicus Curiae* FCC, 2006 WL 2415737, at *11. Yet, when taken in context of the administrative history, the FCC wrote

that "the Commission was considering only calls placed to ISPs located in the same local calling area as the caller." *Id.* at *10. The *ISP Remand Order*, however, does not stand in a vacuum–which is the only setting where Level 3's argument could survive.

After recognizing the *ISP Remand Order's* lack of clarity concerning the intended reach of the FCC's action, the FCC's brief recounted the administrative actions leading up to the *ISP Remand Order*. *Id.* at *12. Beginning with the *Local Competition Order* and again in the *Declaratory Ruling*, the FCC was "focused on calls between dial-up users and ISPs in a single local calling area." *Id.* In spite of the historical evidence supporting the conclusion that the FCC never expanded its analysis beyond calls originating and terminating in the same local calling area, Defendants cling to the FCC's acknowledgment that "[t]he ISP Remand Order . . . can be read to support the interpretation set forth by either party." *Id.* at *13. While either reading may be permitted, only one finds significant support in the administrative history preceding the *ISP Remand Order*. Tellingly, the FCC concluded by noting that "the Commission did not directly address VNXX calls in either of its ISP orders and has not addressed VNXX calls more generally." *Id.* Any likelihood that the FCC intended to indirectly address VNXX ISP-bound traffic is heavily outweighed by the evidence which supports a more limited reading, and the FCC's *amicus brief* further supports the Court's conclusion in this regard.

e. Relevant Case Law Interpreting the *ISP Remand Order*

In each instance that the United States appellate courts have addressed VNXX traffic, the courts have recognized that the FCC's analysis in the *ISP Remand Order* was limited to traffic carried from a caller located within the same local calling area as the terminating ISP. *Global NAPs I*, 444 F.3d at 73-74 (quoting *ISP Remand Order*, 16 F.C.C.R. at 9159, ¶ 13) ("The issue that necessitated FCC action in the [*Declaratory Ruling*] and the *ISP Remand Order* was 'whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP in the same local calling area that is served by a competing LEC.'");*Global NAPs II*, 454 F.3d at 99 ("The ultimate conclusion of the 2001 [*ISP*] *Remand Order* was that ISP-bound traffic within a single calling area is not subject to

reciprocal compensation. . . . Although the 2001 Remand Order states explicitly that ISPs are exempt from reciprocal compensation for intra-local calling area calls, it sheds little light on inter-local calling area calls or access fees."); *Peevey*, 462 F.3d at 1158-59 (finding the rate caps imposed by the *ISP Remand Order* irrelevant to the issue of intercarrier compensation for VNXX ISP-bound traffic because "[t]hose rate caps are intended to substitute for the reciprocal compensation that would otherwise be due to CLECs for terminating *local* ISP-bound traffic.") (emphasis added); *In re Core Commc'ns*, 455 F.3d at 272 (recounting the holding of the *ISP Remand Order* and recognizing that it applies to "calls made to ISPs located within the caller's local calling area"); *Worldcom*, 288 F.3d at 430 ("In the [*ISP Remand Order*] the [FCC] held that under § 251(g) of the Act it was authorized to 'carve out' from § 251(b)(5) calls made to Internet service providers ("ISPs") located within the caller's local calling area.").

Recognizing the significance of these cases, Level 3 devotes some fifteen pages of its Reply to arguments that attempt to distinguish each case factually from the situation presented to this Court. In doing so, Level 3 misses the point. The Court does not rely on these cases for their primary holdings, none of which address the precise issue presented here. Instead, each case, either in the background or analysis, identifies the scope of the FCC's action in the *ISP Remand Order*, which is of primary interest to the Court. Each decision makes reference to the fact that in drafting the *ISP Remand Order*, the FCC was only considering calls placed by a caller in the same local calling area as the terminating LEC's ISP customer, and, for that reason alone, these circuit court cases are highly relevant to the dispute in this case.

2. Conclusion

Regrettably, in this instance, the rapid proliferation of ever evolving telecommunications technology has outpaced the regulatory framework within which it must operate. The result is a technology which defies certain assumptions intrinsic in the present statutory scheme. Nevertheless, it is impermissible to attribute an intention to the FCC that may make sense in retrospect, but clearly was not part of the analysis at the time the order

was entered. Perhaps the most sensible observation made in Level 3's brief is the realization that "VNXX traffic does not fit the traditional 'local' model, but it is equally plain that this traffic does not fit the traditional model of a 'long distance' call either." (L 3 Brief at 26.) The Court is in complete agreement. This is precisely the reason that the Court cannot conclude that the FCC intended to include VNXX traffic within the definition of the term "ISP-bound traffic" in the *ISP Remand Order*. The Court has determined that the FCC intended to remove ISP-bound traffic from the confines of § 251(b)(5), but only in regards to traffic that was subject to such reciprocal payments before the issuance of the *ISP Remand Order*. Whether VNXX traffic was among the calls subject to such reciprocal payments is not a question that this Court can answer. Until such time that VNXX is addressed by the ACC, the parties' dispute cannot be resolved.

For all of the reasons given above, the term "ISP-bound traffic" as it appears in the ISP Amendment incorporates the definition from the *ISP Remand Order*, which did not address VNXX traffic. To the extent that the ACC's ruling in the Level 3 matter conflicts with this determination, it is in violation of federal law.

D. Qwest v. Pac-West

Although the Pac-West ISP Amendment and the Level 3 ISP Amendment do not mirror each other, an examination of the relevant contract terms leads the Court to the same result. As above, the Court looks first to the parties' agreement to determine whether it can be enforced as written, or whether it necessitates interpretation of federal law to give meaning to its essential terms.[3] In its order, the ACC wrote that it "base[d] its decision . . .

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[3]At oral argument, Defendants reasoned that any contractual ambiguity concerning VNXX should be construed against Qwest, the party allegedly responsible for drafting the ISP Amendments. (*See also* Reply Br. of Pac-West Telecomm, Inc. ("P-W Reply") at 7.) In support thereof, Defendants directed the Court to the level of specificity found in the change of law provision (section 6) of the Pac-West ISP Amendment, which illustrates the precision used in drafting the agreement. Defendants suggest that Qwest, had it actually meant to exclude VNXX traffic from the ISP Amendment, had ample opportunity to do so at the time of formation of the agreement.

The Court agrees with Defendants' general premise, but finds that their own actions

on the plain language of the specific contract terms." (P-W R., ACCD at 10, ¶ 26.) Upon review of the specific contract terms, however, it is clear that the plain language mandates interpretation of the *ISP Remand Order* to give meaning to the disputed term, "ISP-bound." The relevant contract provision states: "Qwest elects to exchange ISP-bound traffic at the FCC ordered rates pursuant to the [*ISP Remand Order*]." (P-W Reply, Ex. 1 ("P-W ISP Amendment") at 2, § 3.1.) The term "ISP-bound" is defined in the contract as follows: "'ISP-Bound' is as described by the FCC in its [*ISP Remand Order*]." (P-W ISP Amendment at 2, § 1.4.)

No permissible interpretation of the essential provision can be made without first establishing exactly what was meant by the FCC when it used the term "ISP-bound" in the *ISP Remand Order*. Having done that above, it is unnecessary to reexamine the issue as Pac-West has not advanced any substantially different reasoning in support of its interpretation of the breadth of the *ISP Remand Order*. Therefore, the Court concludes that the ACC's order in the Pac-West matter violates federal law by failing to properly interpret the *ISP Remand Order*, which was fundamental to the ACC's interpretation of the Pac-West ISP Amendment.

E. Injunctive and Declaratory Relief

In its Complaint, Qwest identifies eight separate areas of injunctive and declaratory relief that it asks the Court to grant. (Compl. at 17-18.) However, in its briefing of the issues, Qwest narrows the requested relief and focuses on three actions it wishes the Court

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undermine the legitimacy of their position. Regardless of which party actually drafted the agreements, both Qwest and Defendants are highly sophisticated entities who were well aware of the issues surrounding VNXX at the time of the signing of the ISP Amendments. In fact, it is the CLECs, not Qwest, who employ this technology and therefore most likely have an equal, if not greater, understanding of its implications and risks. None of the parties to the ISP Amendments sought to mitigate the risk of future disputes over the use of VNXX, and, as a result, they all share in the uncertainty of seeking judicial construction of ambiguous contractual terms.

to take. (Qwest Corp.'s Reply Br. ("Qwest Reply") at 27.) The Court now turns to discuss the relief granted.

Qwest first asks the Court to declare "that the *ISP Remand Order* prescribes intercarrier compensation only for calls placed by a caller to an ISP located in the same local calling area." (Qwest Reply at 27.) As this statement is consistent with the findings above, it is adopted by the Court and becomes part of this Order. Next, Qwest seeks a "holding that [ACC] Decision[] Nos. 68820 and 68855 violate Section 251(g) of the [TCA]." (Qwest Reply at 27.) Qwest's position is premised on its belief that VNXX is covered by § 251(g) and, therefore, subject to access charges. As explained more fully below, the Court is instructing the ACC to determine the most appropriate compensation regime for VNXX, thus, the Court will not enter the order as requested by Qwest. To do so would recognize that access charges are the method of compensation to be applied to VNXX–that is not the Court's decision to make. Finally, Qwest seeks an injunction preventing "enforcement of Decision Nos. 68820 and 68855 because they are based on incorrect interpretations of the *ISP Remand Order* and the ISP Amendments implementing the *ISP Remand Order*." (Qwest Reply at 27.) Where the ACC Decisions conflict with the language of this Order, the ACC is enjoined from enforcing those Decisions. Those portions of the Decisions not in conflict with this Order remain intact.

No party to this action can achieve the ultimate financial result they seek until the ACC definitively categorizes VNXX.[4] This must occur before any determination can be made as to which party may be entitled to compensation, or reimbursement, for VNXX ISP-bound traffic transported since the entry of the *ISP Remand Order*. The ACC may find that VNXX is local, i.e., it originates and terminates in the same local calling area. In the

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[4]In the ordering section of this Order, the Court provides the parties with one final opportunity to amicably resolve the issue of past and present intercarrier compensation for VNXX ISP-bound traffic. Should the parties choose to capitalize on this opportunity, it will be unnecessary for the Arizona Corporation Commission to undertake the thorough review of VNXX traffic contemplated by this section.

alternative, the ACC may determine that VNXX is not now, or that it never was, local traffic subject to reciprocal compensation, and instead that it is subject to access charges. *See Global NAPs II*, 454 F.3d at 101 (hypothesizing that "[V]NXX's potential compensation arrangement . . . [could] possibly involve toll and access charges"); *Global NAPs I*, 444 F.3d at 72 (holding that "the *ISP Remand Order* does not clearly preempt state authority to impose access charges for interexchange VNXX ISP-bound traffic"). As a third option, the ACC could opt for some other yet-to-be defined rate scheme that the ACC deems appropriate.

The aforementioned resolutions are intended merely to suggest potential dispositions of the VNXX issue. They are not exclusive of other equally reasonable potential solutions, and do not bind the ACC to reach a particular result. The ACC shall deal with VNXX, however, any decision is to be guided by its own discretion and no party may rely on this Order to argue that a particular result is required. The Court expresses no opinion as to the proper resolution of this matter and, as evidenced by the disparate conclusions reached by other states that have addressed this issue, concludes that more than one reasonable solution exists.

In declaring the intended coverage of the *ISP Remand Order* and requiring the ACC to make difficult decisions concerning VNXX traffic, the Court fulfills its duty to resolve the challenged ACC action without stepping into areas best reserved for those with telecommunications regulatory expertise. In the Pac-West ACC Order, the Commission stated that it was "disinclined to make a sweeping pronouncement regarding the appropriateness of VNXX as it relates to intercarrier compensation," with the source of this sentiment being its general "unwillingness to determine a matter of such gravity without broad industry participation." (P-W R., ACCD at 10, ¶ 27.) So too, this Court is unwilling to make such a broad pronouncement concerning the character of VNXX traffic. Additionally, the Ninth Circuit in *Peevey* signaled that it is clearly permissible for state commissions to address the VNXX issue. *Peevey*, 462 F.3d at 1158 (upholding the state commission's actions where it "applied its *own* balancing test in determining as a matter of fair compensation policy that VNXX traffic is subject to reciprocal compensation as 'local'

traffic; it did not make that determination under the [TCA] or the FCC's rules for reciprocal compensation").

IT IS ORDERED enjoining enforcement of those portions of Arizona Corporation Commission Decision Nos. 68820 & 68855 that conflict with this Order.

IT IS FURTHER ORDERED remanding Decision Nos. 68820 & 68855 to the Arizona Corporation Commission for further consideration and action consistent with the findings of this Order, specifically Section E, Injunctive and Declaratory Relief.

IT IS FURTHER ORDERED that those portions of the ordering paragraphs of Arizona Corporation Commission Decision Nos. 68820 & 68855 not affected by this Order remain in force.

IT IS FURTHER ORDERED that the parties have 120 days (commencing the day of entry of this Order) to resolve their ongoing dispute concerning intercarrier compensation for VNXX ISP-bound traffic by mutual written agreement as an amendment to their interconnection agreements.

IT IS FURTHER ORDERED that, in the event the parties are unable to fully resolve all past and present issues concerning intercarrier compensation for VNXX ISP-bound traffic, the Arizona Corporation Commission shall designate intercarrier compensation for VNXX ISP-bound traffic. The Commission's order must set forth rates of intercarrier compensation for VNXX ISP-bound traffic retroactive to the date of the *ISP Remand Order*. This retroactive compensation may change with the progression of time and need not mirror the future rate scheme. The Commission may address these VNXX issues using the generic docket opened in Arizona Corporation Commission Decision No. 68820.

DATED this 20th day of November, 2007.

Susan R. Bolton
United States District Judge